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October 13, 1993

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte: MM Docket No. 93-215

Dear Mr. Caton:

In this letter, Continental Cablevision, Inc. ("Continental") responds to certain points contained in the September 14, 1993, Reply Comments submitted by the GTE Service Corporation and its operating telephone companies (GTE) in the above-captioned matter.

1. **Subscriber Addressability In The Benchmark Formula**

GTE contests the determination by Continental's expert, Dr. David Roddy, that addressability has a significant effect on the Commission's benchmark equation and thus should be reflected in the benchmark rates in some manner. GTE argues that the Commission should not accept Dr. Roddy's approach and should ignore these substantial costs. **See** GTE Comments at 5-6. According to GTE, the only correct approach is to re-run the entire analysis underlying the benchmark equation, and, failing that, the benchmarks should not be adjusted in any way to reflect addressability. **Id**. GTE is wrong for several reasons.

Continental's expert, Dr. David Roddy, demonstrated that addressability has a significant impact on the results of the Commission's benchmark equation: systems with addressability tend to have higher prices than those that do not. **See** Comments of Continental Cablevision, Inc. (August 25, 1993), Exhibit D, Appendix 2.

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Dr. Roddy used the same stepwise regression procedure that the Commission used in deriving the benchmarks, and found that addressability always enters as a key variable. (Time-Warner reached the same results when testing Continental's submission. See Continental Reply Comments at 24 n. 26). GTE presents no evidence of any statistical analysis of the benchmark data or regressions that contradicts the separate determinations by Continental and Time-Warner. The intention of the Commission was to test "other characteristics expected to be related to prices." Report & Order in MM Docket 92-266, Appendix E at ¶27, May 3, 1993. The data shows that addressability clearly should have been included in the benchmark tables, and cannot now be ignored.

Including addressability as a key variable is an intuitively reasonable result. The record in MM Docket 92-262 (anti buy-through) and the Commission's own Equipment Compatibility Report demonstrate that the headend and subscriber premises equipment needed to address particular programming to particular subscribers adds substantial costs to a system. The Commission reported one example to Congress of a system where the cost of the basic headend equipment is $10,000-$15,000, plus $2,000-$3,000 per scrambled channel, plus $100,000-$150,000 for set-top descramblers. Consumer Electronics and Cable System Compatibility, Report to the Congress, October 5, 1993, at 16. The record in MM Docket 92-262 shows even greater costs for systems of even modest size. Those costs should be reflected in the prices charged by systems that have incurred them.

Second, GTE's innuendo urging "caution" on this topic does not undermine the mathematical validity of Dr. Roddy's analysis or his proposal to create an "add-on" to the benchmarks. The Commission itself asked commenters to suggest "add-on" factors to the existing benchmark equation. "Operators who could demonstrate the existence of such factors might then be permitted to charge rates equal to the <u>benchmark plus an 'add-on' amount</u> attributable to those extraordinary factors." Notice of Proposed Rulemaking at ¶72. Dr. Roddy's supplementary regression, based on the residuals in the existing benchmark calculation, responds directly to this request. It is certainly theoretically possible, as GTE suggests, to re-run the benchmark regression to reflect addressability directly, but in practical terms such an approach would be ill-advised. That process would take many months to complete, including new regression analyses, a new round of comments and replies, new benchmark tables, and a new version of Form 393. Had the Commission invited such proposals, the September 1 implementation date would have been impossible.

GTE also attacks the add-on approach because it uses an average approach to create simplified table of 11 values rather than a different adjustment for each cell in the benchmark table. Dr. Roddy noted that a more complex approach was possible, Exh.

D, App. 2 at 5 n. 11, but such an approach would double the size of the benchmark table. That would hardly constitute the streamlined approach which the Commission has solicited.

Operators who have incurred the costs needed to make their systems addressable will find that the unmodified benchmark tables lead to unreasonably low earnings. Failing to make the adjustment recommended by Dr. Roddy will force those systems into expensive and time-consuming cost-of-service showings, undermining reliance on benchmarking as the primary tool for rate regulation.

Dr. Roddy's presentation establishes unequivocally that subscriber addressability impacts cable rates, and he has proposed a specific, workable way to incorporate addressability into the Commission's benchmark tables. GTE's suggestion that the Commission ignore these facts should be rejected.

2. **Productivity Offset**

GTE has also argued that the Commission should apply identical regulatory regimes to the cable television and local telephone businesses. In particular, GTE has argued that the 3.3% "productivity" offset applied to Tier 1 LECs should, without any supporting data, be applied to cable under the rate benchmarks.

The Commission has already confronted GTE's arguments:

> Telephone companies have failed to advance a sufficient reason why we should adopt as an overriding policy goal achieving parity in price cap mechanisms for the two industries. Instead, our price cap requirements for cable and telephone services are, and should be, based upon the respective separate consideration we discussed in the proceeding in which we adopted those respective requirements.

First Order on Reconsideration in MM Docket 92-266, FCC 93-428 at ¶90 (August 27, 1993). GTE's Reply Comments ignore this directive and seek reflexive adoption of the 3.3% LEC productivity offset, without any supporting data whatsoever.[1]

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[1] The Commission should note the internal contradiction in GTE's approach: When the issue is addressability, GTE urges that the Commission do nothing in the face of clear data mandating some action. When the issue is productivity, by contrast, GTE asks the Commission to impose an unjustified and arbitrary 3.3% productivity offset when the available data do not support any particular offset

Dr. Roddy explained that there is no justification for including a productivity offset in the cable television price cap formula. Dr. Roddy himself stated in his report that "the correct approach to productivity measurement in the cable industry requires investigation of the total factor productivity concept." Continental's Exhibit D, App. 3, page 4. GTE basically agrees. **See** GTE Reply Comments at 8-12. If the only valid basis for establishing a productivity offset is a TFP study, then GTE has conceded that the record does not contain sufficient evidence to support such an offset, because no TFP study of the cable industry exists. The data needed for a valid Total Factor Productivity (TFP) analysis are not available. **See** Continental Comments, Exhibit D, Appendix 3.

If, despite this lack of data, the Commission were to try to base a productivity offset on a very simplified analysis, then, as Dr. Roddy has shown, the best estimate for the "offset" is 0%. **See** Continental's August 25 Comments, Exhibit D, Appendix 3 and pp. 88-91. From either perspective, it would be arbitrary and capricious for the Commission to impose the productivity offset GTE suggests.

Respectfully submitted,

CONTINENTAL CABLEVISION, INC.

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at all. As Continental has previously stated, the LECs are advancing positions intended primarily to frustrate cable television's ability to compete, rather than to facilitate the creation of a just set of rate regulations.